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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street NW, Room 222
Washington DC 20554

Re: Review of the Commission's Regulations Governing Television Broadcasting (MM Docket No. 91-221)

Dear Mr. Caton:

Enclosed for filing in the record of the above proceeding are 10 copies of a two-volume study entitled "An Economic Analysis of the Broadcast Television National Ownership, Local Ownership and Radio Cross-ownership Rules" which Economists Incorporated has prepared on behalf of Capital Cities/ABC, Inc., CBS Inc., National Broadcasting Company, Inc. and Westinghouse Group W.

Sincerely,

Enclosures

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BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

In re:

Review of the Commission's Regulations Governing Television Broadcasting	MM Docket No. 91-221

AN ECONOMIC ANALYSIS OF THE BROADCAST TELEVISION NATIONAL OWNERSHIP, LOCAL OWNERSHIP AND RADIO CROSS-OWNERSHIP RULES

Volume 1

May 17, 1995

ECONOMISTS INCORPORATED

WASHINGTON, D.C.

Executive Summary

This economic report addresses three of the Commission's broadcast station ownership rules: the national ownership restrictions, the local ownership rule standards, and the television-radio cross-ownership rule. The application of competition (antitrust) policy analysis to questions of broadcast station ownership provides the Commission with a sound policy framework. Economic analysis within this framework can help the Commission assess the likelihood that changes in or abolition of its ownership rules will lead to anticompetitive behavior with respect to viewers, advertisers or program suppliers. Even with respect to such non-economic objectives as diversity, the tools of economic analysis can be helpful in assessing the likely effects of various policy changes, as well as the economic cost of pursuing diversity goals.

The economic approach in this report is based on competition policy analysis. This analysis leads to the following conclusions:

- National ownership rule: The application of generally-accepted merger standards to the economic structure of the broadcasting industry produces no justification for the present limitations (12 stations or 25 percent reach) on television station ownership, either in terms of effects on competition or in terms of economically reasonable diversity concerns. Broadcast stations compete in broad, relatively unconcentrated markets for advertising and for audiences. Broadcasters in different cities do not compete with each other. Increases in the size of broadcast groups would not threaten the competitiveness of program acquisition markets. Because no anticompetitive effects are likely to arise from increases in group ownership that go beyond the limits of the present rule, to prevent such transactions is to limit the efficient operation of the markets affected. Changes in ownership should be reviewed on a case by case basis, applying appropriate competition policy standards.

- Local ownership rule: The rule banning joint ownership of two stations in the same market is set forth in terms of overlapping

Grade B contours. This definition is too strict. Generally, stations whose only overlap is in Grade B contours should not be regarded as competing for viewers. In the typical case, the extent of the overlap will be a small fraction of the potential audience of each station, likely too little to cause either station to change its behavior in response to changes in the behavior of the other. Such stations are commonly located in separate DMAs, in which case they do not compete significantly for advertising revenue. In many cases, stations with such an overlap also will not compete against each other in the purchase of video programming. Moreover, even if stations in separate DMAs with overlapping Grade B contours were regarded as in the same market, concentration would generally be decreased by the greater number of competitors in the enlarged geographic market. Finally, in some markets combinations of stations with overlapping Grade A contours would not threaten competition or diversity.

- Radio-television cross-ownership rule: The Commission's rules currently permit common ownership of two AM and two FM radio stations in cities with a sufficient number of competitors, but forbid common ownership of television stations and radio stations, subject to limited waivers. There is no basis in competition policy for a rule of this sort. Generally, proposals to increase cross-ownership should be scrutinized under applicable antitrust merger standards. In most large markets, there is room for substantial increases in radio-television combinations before competition in the purchases of programs, the supply of advertising or diversity would be threatened.

These conclusions are based on analysis of the various markets in which broadcasters compete. The Commission itself has tentatively identified and analyzed those markets and has concluded that significant relaxation of its ownership rules would not increase the potential for anticompetitive behavior. While the Commission's general conclusion is sound, in many instances its market definitions are overly narrow. This report presents data that shed further light on the Commission's market definitions, as well as on the broader market definitions that better comport with the results of competitive analysis. The conclusion is inescapable, even using the market definitions suggested by the Commission, that broader and more rapid deregulation is warranted. The present ownership policies preclude transactions that would enhance economic welfare without threatening competition. So long as these policies remain in effect, the economy suffers irreparable losses. More accurate and inclusive market definitions lend even greater support to the need for more extensive and rapid deregulation.

- Delivered video programming: Television broadcasters supply video programming to audiences. The alternatives available to viewers include cable television, direct broadcast satellite service, and rental or purchase of video cassettes, among other sources. Also, there is no evidence to contradict the common sense observation that other leisure-time activities compete with television viewing for the attention of the audience. Markets in which television stations compete for audiences are largely local, but are also supplied by national sources such as DBS. Concentration in local markets varies, being generally lower in the larger markets. Even in markets where there is modest concentration, anticompetitive behavior is unlikely on account of the nature of the product.

- Advertising: Broadcasters compete in national and local advertising markets. At the national level, broadcast networks, national spot sellers, cable networks, barter-syndicators and national print media all compete for the budgets of national advertisers. In addition, marketing strategies such as coupons and direct mail compete with advertising media. Advertising markets at the national level are unconcentrated. While local markets must be addressed on a case-by-case basis, the larger markets are unconcentrated and successful collusion is unlikely on account of the characteristics of the product.

- Video program production: At the national level purchases of video program rights are widely dispersed and unconcentrated. At present levels of concentration there is no danger of the exercise of monopsony or oligopsony power in this market. At the local level, purchasers in different geographic markets do not compete for programming.

- Diversity: There is little economic support for the proposition that increased concentration of ownership of broadcast media will lead to less viewpoint diversity. Diversity goals that reach beyond what can be achieved by a competitive market can cause economic losses to consumers, by imposing an inefficiently small scale of production on the industry. The application of competition policy to the evaluation of station ownership is likely to result in adequate protection of diversity concerns because diversity "markets" are probably broader than economic markets.

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I. Introduction

A. Consumer welfare and efficient use of resources should guide regulatory policy

This report is concerned with economic analysis of three of the Federal Communications Commission's broadcast television ownership rules on which the Commission has requested comment in its Further Notice.[1]

The Commission has identified two bases for these rules, one grounded in economics and the other grounded in the Commission's long-standing diversity concerns. Commission policy with respect to these issues should be guided by their effects on consumer welfare. Ownership patterns in the absence of any rules can be presumed responsive to consumer interests, either in terms of the types and quantities of service provided, or in terms of cost savings from effective use of resources. This presumption breaks down, of course, when an ownership pattern or structure leads to market power. Therefore, from an economic point of view, the Commission's ownership rules should be guided by the principles underlying competition policy. There is no economic basis, in other words, for ownership rules stricter than those that would be imposed by the application of generally accepted antitrust standards.

The analysis in this report demonstrates that reliance on current antitrust enforcement standards would protect the public both from the creation of market power and from any undue reduction in diversity. Despite some quibbles about the details, modern U.S. antitrust enforcement standards and methods of analysis are widely accepted, and are being adopted throughout the world.

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1 FCC, *Further Notice of Proposed Rule Making,* MM Docket No. 91-221 & 87-8, released Jan. 17, 1995 [hereinafter Further Notice or FNPRM].

B. Antitrust standards will protect consumer welfare and the efficient use of resources

The particular antitrust standards applicable to station ownership issues are merger standards. Under §7 of the Clayton Act, U.S. antitrust policy is designed to stop *in their incipiency* concentrations that threaten consumer interests. For this reason, merger standards are much stricter than standards applicable to unilateral actions by an alleged monopolist.[2] Current merger law permits the enjoining, in certain circumstances, of an acquisition that would merely increase concentration in a market, but not create a firm with monopoly power. In other words, merger policy acts to stop threats to the consumer interest in competitive markets long before a monopoly is created.

The U.S. Department of Justice/Federal Trade Commission *1992 Horizontal Merger Guidelines* enunciate the methods and standards that those agencies apply to screen potentially troublesome mergers. The *Guidelines* have wider application, however, and their methods and standards are used in other antitrust contexts, including private litigation, and by other government agencies.

C. Antitrust enforcement will ensure diversity

The Commission's concern for diversity can be treated in various ways from the perspective of consumer welfare. For example, one can ask whether any particular ownership pattern produces a variety of programming that fails to maximize consumer welfare, other things equal. The answer to this question can guide policy. Alternatively, the Commission might set a particular objective in terms of diversity that exceeded what consumers would be willing to pay for. In this case, the public policy issue would be how much consumer economic welfare to sacrifice in order to achieve the Commission's non-economic objective. Fortunately neither of these alternatives is relevant because the application of merger standards to the ownership question guarantees a great deal of diversity.

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2 Brown Shoe Co. v. United States, 370 U.S. 294, 312–323 (1962); LAWRENCE ANTHONY SULLIVAN, HANDBOOK OF ANTITRUST LAW 593–94 (1977)

To put the matter a different way, the application of merger standards would stop any given merger or acquisition on economic grounds long before a significant reduction in diversity was threatened. This is true in part because the marketplace for ideas is broader than the markets relevant for competitive analyses.

D. The Clayton §7 approach to merger analysis

When Congress enacted the Celler-Kefauver amendment to the Clayton Act in 1950, the economic standard under which proposed mergers were judged changed considerably. After that time, Clayton §7 became concerned not merely with the deterrence of monopoly, but with the elimination *in their incipiency* of trends toward undue concentration of economic power and anticompetitive behavior. The Clayton Act, a fundamental element of U.S. antitrust law, thus imposes strict standards of scrutiny on mergers and acquisitions, including those in the broadcast industry.

Because the Clayton Act provides for strict scrutiny of mergers and acquisitions, it is reasonable to presume that it could usefully serve as a guarantee that proposed concentrations of broadcast station ownership do not pose threats to competition or to the welfare of viewers and listeners. By the same token, merger or acquisition transactions that pass muster under Clayton §7 standards can be presumed to offer benefits to the economy.

It is useful to illustrate the operation of Clayton §7 merger enforcement standards and practices by reference to the U.S. Department of Justice/Federal Trade Commission *Merger Guidelines*.[3] The *Guidelines* express the current enforcement intentions and philosophies of the federal antitrust agencies, and as such they naturally reflect a prosecutorial viewpoint. Further, the *Guidelines* generally reflect a somewhat stricter set of

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3 The current *Merger Guidelines* were released in 1992, although certain provisions of the 1984 release remain in effect.

standards than those applied in practice.[4] Still, a review of the *Guidelines* approach serves as a useful roadmap of Clayton §7 analysis and how it might be used to assess the competitive implications of station ownership changes.

The first step in merger analysis is product market definition.[5] The "relevant" market in which a merger is analyzed includes all those products (or services) that, together with the products of the merging parties, would have to be controlled by a hypothetical monopolist in order to raise prices profitably. Such markets are generally defined in terms of the smallest set of products that meet the criterion. The price increase is assumed to be "small but significant and non-transitory." The point of this process is to identify the alternatives available to customers of the merging parties. Thus, market definition is carried out from a demand-side perspective.

The second step in merger analysis is to define a relevant geographic market. A geographic market must pass the same conceptual test as a product market. It must be the smallest area containing the products of the merging parties that a hypothetical monopolist would have to control in order to profitably raise prices. A relevant geographic market might, for example, contain the products of firms located at great distances if their products were, or could readily be, consumed in the market.

The third step in merger analysis is to decide which firms should be included as sellers in the market. In addition to current sellers of products in the relevant market, these include sellers not currently making the

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4 It is uncommon for the federal antitrust authorities to conclude that a merger of competing firms would reduce competition if the post-merger HHI would be less than 1,800, as would be the case, for example, if there remained six equal-size competitors after the merger. Malcolm B. Coate and Fred S. McChesney, *Empirical Evidence on FTC Enforcement of the Merger Guidelines*, ECONOMIC INQUIRY 277-93 (April 1992).

5 Throughout this report the term "market" is used in a variety of contexts to illustrate the use of economic analysis applicable to the evaluation of the Commission's rules. Nothing herein is intended to imply a judgment concerning the relevant antitrust market for any specific transaction or practice that is the subject of antitrust litigation. As explained below, each case requires its own analysis.

product but readily capable of doing so, and firms outside the geographic market that could readily enter it. Generally, sellers are included in the market if they could enter in less than a year.

The fourth step is to measure concentration in the market thus defined. Concentration formerly was measured by computing the market shares of the largest four or eight firms. Currently, a Herfindahl-Hirschman Index (HHI) is computed. The HHI is defined as the sum of the squared market shares of each firm in the market.

The fifth step is to apply some standard to assess the measured concentration. According to the *Merger Guidelines*, mergers resulting in an HHI below 1,000 will not be further investigated. Mergers with HHIs above 1,800 are presumed anticompetitive unless further analysis produces contrary evidence. Mergers resulting in HHIs between 1,000 and 1,800 require more detailed analysis. In practice, both the Department of Justice and the Federal Trade Commission tend to use somewhat less strict standards than these.

The sixth step in merger analysis, for those transactions that do not fall into the harmless category at the previous stage, is to consider ease of entry. If a market is easy to enter then it will be impossible for incumbent firms to raise prices above competitive levels, even if the market is highly concentrated. Mergers in markets with easy entry are regarded as not anticompetitive regardless of the level of concentration in the market. The *Merger Guidelines* test for ease of entry is based on two years and the possibility of profitable entry at pre-merger prices.

The seventh step is to consider factors that would make tacit or explicit collusion, or the exercise of unilateral market power, difficult or impossible. For example, if the products involved are not homogeneous then it may be much more difficult to reach and maintain a collusive agreement than if they are homogeneous. In markets with differentiated products, the merger of two firms that are not each others' closest competitors may be treated less harshly.

The eighth step is to consider possible efficiencies resulting from the merger. For example, the firms may require the merger in order to produce some new product or to lower production costs. Such benefits, when clear and convincing, may in some cases outweigh a more speculative increase in the likelihood of anticompetitive behavior based on increased concentration.

This summary of the *Guidelines* approach to merger analysis omits a number of important considerations and details, but provides a useful outline of the basic approach and its purposes.

It is important to note that the vast majority of merger and acquisition transactions have no implications for competition (because they do not involve competitors). These transactions take place because the parties expect to achieve economic gains. Ultimately, these gains must come either from enhanced demand for the products being produced or from cost savings. In either case, consumers are likely in the end to benefit. Even most merger transactions among competitors have as their aim not a reduction in competition but the achievement of cost savings and product enhancements. It is the job of Clayton §7 analysis to weed out those transactions that are likely to harm consumers. If, by a rule, the Commission prohibits *all* mergers or acquisitions of a certain type, without regard to their effects on competition, the result is likely to be lost benefits for consumers and for the economy as a whole.

E. Burden of proof

Because of the presumption that mergers will enhance consumer welfare, those who would have the government intervene in competitive markets bear the burden of justifying this intervention. It is the conclusion of this report that proponents of the continuance of these ownership rules cannot meet this burden of proof.

F. Organization of the report

The report is organized in the same manner as the Commission's Further Notice.

Subject matter	Further Notice	This report
Competition analysis: video programming	Section III. C.	Section II
Competition analysis: advertising	Section III. D.	Section III
Competition analysis: video production	Section III. E.	Section IV
Diversity analysis	Section IV	Section V
National ownership rule	Section V	Section VI
Local ownership rule	Section VI	Section VII
Radio-TV cross ownership rule	Section VII	Section VIII

The analytical Sections (II through V) follow the competition policy approach illustrated above by the description of the *Merger Guidelines* to analyze issues of market definition, concentration and competition. These tools are then used to evaluate the rules.

Section II addresses the Commission's proposed delivered video services market. Based on the evidence examined, this section concludes that the Commission's proposed market definition is too narrow, and that it should include, for example, various non-broadcast video media.

Section III of the report examines the Commission's proposed advertising market definitions, again finding that the Commission's proposed markets are unduly narrow. Section IV addresses the Commission's proposed video program production market. Measures of concentration suggest that national station groups lack market power in the purchase of programming, and would lack such power even if they had 100 percent national coverage.

Section V of the report addresses, from an economic point of view, the Commission's concern for diversity of viewpoints in the provision of